ST 98-28
Tax Type: SALES TAX
Issue: Failure To Verify Or Document Interstate Sales Separately Stating Tax/ Separately Contracting For Audit Methodologies and/or Other Computational Issues

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
ADMINISTRATIVE HEARINGS DIVISION
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS,	**No. 95-ST-0000**
v.	**IBT 0000-0000**
XYZ CORPORATION, INC., Taxpayer	**Linda K. Cliffel Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

APPEARANCES: Brian Wolfberg of Schain, Firsel & Burney Ltd. for the taxpayer; John D. Alshuler, Special Assistant Attorney General, for the Department of Revenue.

SYNOPSIS:

This matter comes on for hearing upon stipulated facts and memoranda of law by agreement of the parties. The Department issued a Notice of Tax Liability ("NTL") No. SF 199400000000000 regarding taxpayer's retailers' occupation tax ("ROT") and use tax liability for the period January 1, 1990 through December 31, 1992. The issues, as agreed to by the parties, are the following:

1. Whether the sales invoices are sufficient evidence to rebut the *prima facie* correctness of the amount of tax due as established by the Correction of Returns and/or the

Determination of Tax Due prepared by the Department's auditor with respect to this matter.

2. Whether an invoice for consumable tangible personal property purchased by the taxpayer and included in the statistical sampling, should be removed from the list of exceptions and taxed as a stand-alone item.

3. Whether projections applied to four stores not open during the entire audit period should be adjusted to reflect the actual period of time in which those stores were in operation.

My recommendation is that the NTL be finalized as to issue number 2, and that issues number 1 and 3 be found for the taxpayer.

FINDINGS OF FACT:

1. The Department's *prima facie* case against taxpayer, including all jurisdictional elements, was established by the admission into evidence of the NTL and Correction of Returns. (Supplemental Stip. Ex. 1(S), 2(S))

2. Taxpayer operates retail stores in Illinois at three locations. (Stip. ¶1)

3. Taxpayer makes sales at all three locations that require delivery to locations outside Illinois. Deliveries to locations outside Illinois are made by common carrier. (Stip. ¶¶2, 5)

4. Taxpayer traced 86% of its invoices which were shipped to locations out of Illinois to the shipping manifest of the common carriers. (Stip. ¶¶13-15)

5. The invoices at issue identify the customer, the delivery destination, a charge for shipping and handling and are marked CHARGE SEND. Each invoice is either signed by the customer or represents an order taken by telephone. (Stip. ¶¶11, 12, 17)

6. The Department included an invoice from "AJAX" Services in its sample for projecting purchases of consumables. The contract between taxpayer and "AJAX" ended in June 1991. (Stip. ¶18)

7. On inbound sales from out-of-state stores, the Department's projections include four new store locations which were not open for business until 8/91, 8/91, 10/91 and 8/92, respectively. (Stip. ¶19)

CONCLUSIONS OF LAW:

I. Interstate Commerce Exemption

The Department disallowed taxpayer's claimed deductions for sales made in interstate commerce. According to Section 2-60 of the Retailers' Occupation Tax Act[1]:

> Interstate Commerce Exemption. No tax is imposed under this Act upon the privilege of engaging in a business in interstate commerce or otherwise, when the business may not, under the Constitution and statutes of the United States, be made the subject of taxation by this State.

Section 7 of the Act places the burden of proof on the taxpayer claiming such an exemption:

> It shall be presumed that all sales of tangible personal property are subject to tax under this Act until the contrary is established, and the burden of proving that a transaction is not taxable hereunder shall be upon the person who would be required to remit the tax to the Department if such transaction is taxable.

Taxpayer was able to identify the shipping manifests which correspond to the invoice for the item shipped in 86 percent of the invoices. The only amounts at issue in this proceeding are the remaining 14 percent of the invoices for which no match could be made. The Department has argued that Departmental regulations require that taxpayer be able to associate the invoice with the shipping manifest in order to claim the interstate commerce exemption.

[1] Unless otherwise noted, references to sections are to the Illinois Retailers' Occupation Tax Act, 35 **ILCS** 120/1 et seq. (hereinafter the "Act").

Department Regulation Section 130.605(e) states:

> To establish that the gross receipts from any given sale are exempt because the tangible personal property is delivered by the seller from a point within this State to a point outside this State under the terms of an agreement with the purchaser, the seller will be required to retain his records, to support deductions taken on his tax returns proof which satisfies the Department that there was such an agreement and a bona fide delivery outside this State of the property which is sold. The most acceptable proof of this fact will be:
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> 1) If shipped by common carrier, a waybill or bill of lading requiring delivery outside this State;
> 2) If sent by mail, an authorized receipt from the United States Post Office Department for articles sent by registered mail, parcel post, ordinary mail or otherwise, showing the name of the addressee, the point outside Illinois to which the property is mailed and the date of such mailing; if the receipt does not comply with these requirements, other supporting evidence will be required;
> 3) If sent by seller's own transportation equipment, a trip sheet signed by the person making delivery for the seller and showing the name, address and signature of the person to whom the goods were delivered outside this State; or, in lieu thereof, an affidavit signed by the purchaser or his representative, showing the name and address of the seller, the name and address of the purchaser and the time and place of such delivery outside Illinois by the seller, together with other supporting data as required by Section 130.810 of this Part and by Section 7 of the Act.
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> 86 Admin. Code ch. I §130.605(e)

While the waybill or bill of lading is "the most acceptable proof" that the sale of tangible personal property is exempt interstate commerce, it is not the only proof that is acceptable. Taxpayer has produced copies of all of its invoices for which the interstate commerce exemption is being claimed. Each invoice bears the name of the customer, the name and address where the item is being shipped, the designation "Charge Send" and a shipping charge. Taxpayer has also introduced copies of its training manual which indicates its policies and procedures concerning interstate transactions. The training manual provides examples of what transactions constitute nontaxable interstate sales and how those transactions are to be recorded. Taxpayer's manual includes the following warning: "No one in our employ can initiate, suggest, arrange or be in

collusion to send merchandise out-of-state with the intent to defraud the states of their taxes." (Stip. Ex. 2, p. 2)

Taxpayer has associated 86 percent of its invoices for items being shipped out-of-state to its shipping manifests. Taxpayer has substantially complied with the Department's regulation and in addition has produced the remaining invoices which give strong evidence that these items were shipped out of state: each one showed the address out-of-state where delivery was to be made and showed a shipping charge, and each such invoice carried the exact information as those invoices to which the Department allowed the exemption. Taxpayer also made it a policy that employees would comply with the rules regarding the reporting of sales so that sales tax would be properly reported.

I find that taxpayer has produced evidence closely associated with its own books and records which establish entitlement to an exemption. Wyndemere Retirement Community v. Department of Revenue, 274 Ill. App. 3d 455 (2nd Dist. 1995). Taxpayer has successfully rebutted the Department's *prima facie* case.

2. "AJAX" Invoice

Taxpayer argues that the sample used to calculate purchases of consumable supplies should be adjusted by deleting the invoice for "AJAX" Services. The contract between taxpayer and "AJAX" ended in June 1991, while the projection was for the entire period January 1, 1990 through December 31, 1992.

Taxpayer has offered no rationale why this particular invoice distorts the sample. By definition a random sample is just that. Any attempt to discard certain invoices will destroy the randomness. There is no dispute that the auditor followed normal statistical procedures in collecting the sample, just that this one item should not be included in the projections.

Taxpayer has not produced sufficient evidence to show that the Department's auditor failed to meet a minimum standard of reasonableness in conducting the audit, and has failed to rebut the Department's *prima facie* case. Therefore, as to the issue of the calculation of the purchase of consumable supplies, I find for the Department.

3. New Store Locations

The Department has included in its projection of items purchased at taxpayer's other locations out-of-state and shipped into Illinois, stores which were not open during the entire audit period. The Department's projections include four new store locations which were not open for business until 8/91, 8/91, 10/91 and 8/92, respectively. Clearly, if the projections are being done on a store by store basis, the auditor is not justified in projecting backwards during periods in which a store is not open for business. In fact, Department's counsel has conceded this point in his brief. Dept. Brief, p. 5) Therefore, on this issue I find for the taxpayer and order that the projection be adjusted to reflect the actual time the new stores were operational during the audit period.

WHEREFORE, for the reasons stated above, it is my recommendation that the assessment of tax liability be revised in accordance with the findings contained herein plus penalties and interest to date.

Date:

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Linda K. Cliffel
Administrative Law Judge